



DIRECTORATE OF
Intelligence

2

Approved for Release
Date DEC 1999

Falkland Islands Dispute: Economic Impact (U)

An Intelligence Memorandum

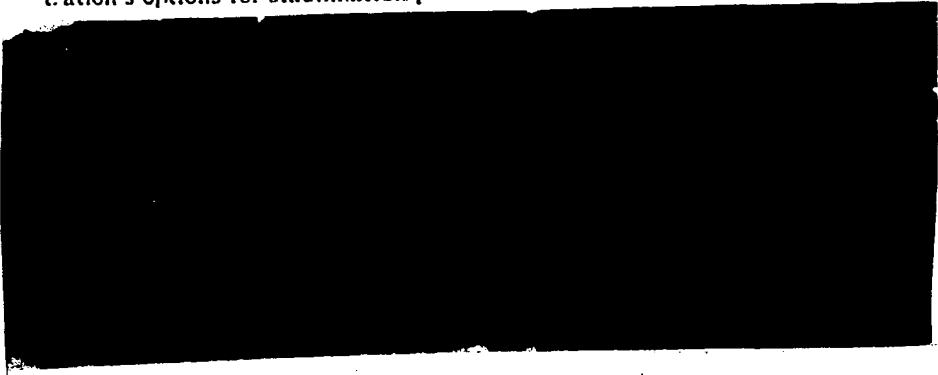
~~Confidential~~
~~NOFORN NOCONTRACT~~

Falkland Islands Dispute: Economic Impact

Summary

The sanctions against Buenos Aires stemming from the Falkland crisis probably will have minimal impact on the Argentine economy in the next 30 to 60 days. The limitations on imports by the United Kingdom and the European Community from Argentina will require some time to take effect. Although there have been a few loan cancellations, Buenos Aires still is far from financial disaster. And, even though some serious technical problems are arising in covering obligations to British banks, there appears to be enough interest on the part of both debtors and creditors to arrange mechanisms to service Argentina's external debts.

Beyond the next few months, the duration of the conflict and the intensity of British measures will be important factors in determining how much disruption occurs to Argentina's economy and foreign financing. At the limit, Buenos Aires has reserves adequate to meet its debt obligations and basic import requirements over the next three to five months, so long as the British do not choose to blockade Argentine merchant shipping. Such a lengthening of the crisis would, however, add to existing Argentine economic problems and substantially raise the risk of a generalized debt rescheduling in 1982. Moreover, the political fallout of growing inflationary pressures and shortages would seriously constrain the Galtieri administration's options for stabilization policies.



~~Confidential~~
~~NO FORN DISSEM~~

Falklands Islands Dispute: Economic Impact

European Economic Sanctions

The British were quick to react to the affront represented by Argentina's invasion of the Falklands. London:

- Announced a ban on imports of Argentine goods.
- Froze Argentine financial assets in the United Kingdom.
- Cut off export credits and military sales.

The European Community (EC) weighed in by approving a 30-day ban on trade with Argentina. This measure, which follows a previously approved cutoff in arms sales, at first appeared more immediately stringent than subsequent information made clear. It will not apply to goods under prior existing contracts, and most EC imports from Argentina are covered by long-term contracts.

Argentine Reprisals

Buenos Aires was quick to retaliate. On 5 April the Argentine Central Bank froze British assets and announced legal measures to restrict foreign exchange payments to British entities—exporters, importers, banks. The government also ordered the suspension of export credit insurance for UK-bound shipments and denied trade credit without prior approval.

Financial Repercussions

- Argentine borrowers were caught in a sudden financial crossfire:
- A \$250 million loan for an Argentine utility was canceled when a UK financial institution withdrew from the syndication.

Argentine exchange restrictions have imperiled debt servicing commitments by preventing payments to UK banks. Failure to make loan repayments to these banks could enable them to declare Argentine loans in default under the loan agreements terms.¹ This situation could be complicated by any increase in national pressures within Britain to demand strict adherence to original loan payment provisions, even though it is in the best interest of the banks to reach an amicable conclusion.

¹ The provisions for such declarations depend on the terms and circumstances of the loan agreements. Syndicated credits often call for declarations of default to be based on a decision made by a majority of the participating banks.

~~Confidential~~

3 5 9 6

~~Confidential~~

Table 1

Million US \$

Argentina:
Direction of Trade, 1981 *

	Exports	Percent	Imports	Percent
Total	9,130	100	9,200	100
EC	2,200	24	2,445	26
Of which:				
United Kingdom	230	2	315	3
Soviet Union	2,700	30	NA	NA
LAFTA	1,935	21	1,815	20
United States	670	7	2,055	22
Japan	275	3	800	9
Other	1,350	15	2,085	23

* Revised estimates.

Buenos Aires is working to avert a financial crisis

Near-Term Impact

For the moment, the British and Argentine countermeasures are having only a limited impact. The bilateral trade cutoff affects only about \$550 million in trade with the United Kingdom. This represents about 3 percent of Argentina's total trade, and an even smaller percentage of UK trade.

A crisis lasting no more than one or two months would be unlikely to cripple the Argentine economy. Despite the cancellation of some foreign loans, Argentina can probably meet foreign exchange requirements.

~~Confidential~~

~~Confidential~~

[REDACTED] Consequently, Buenos Aires probably has enough foreign exchange reserves and access to additional funds to avoid sharp increases in unemployment, cutbacks in imports, or serious rationing for the near term. [REDACTED]

Even so, we cannot rule out a sudden Falkland-related financial panic. [REDACTED]

[REDACTED] For the moment, the government remains in control and is bolstered by widespread domestic political support for its military and diplomatic initiatives. [REDACTED]

Although Buenos Aires has sufficient foreign exchange to function normally over the next few months, an eroding international credit standing will make borrowing more difficult in the near future. Argentina will continue to experience technical difficulties in arranging loan repayments to British banks and syndicates. Credit may tighten as US and other international financial institutions become more cautious regarding debt rollovers and extensions of new credits. [REDACTED]

Longer Range Impact

If the crisis is prolonged, externally imposed trade restrictions will take an increasing toll.³ The suspension of trade with the EC potentially could extend to affect some 25 percent of Argentina's total foreign commerce. At a minimum, the Falkland dispute will impede Buenos Aires's ability to improve its current account position in 1982. Should access to credit facilities dry up, reserve drawdown by itself would not be sufficient to meet debt service obligations this year. Argentina could thus be forced to a rescheduling by the end of 1982. [REDACTED]

The broader risks for the Argentine economy are severe. Concern is growing over Buenos Aires's ability to sustain necessary economic reforms. The Central Bank, for example, has recently increased monetary expansion. Moreover, military spending in support of the Falkland campaign would increase the public deficit. Taken together, these additional economic stimuli would push inflation beyond the present 130-percent level. [REDACTED]

Buenos Aires's international credit rating may suffer over the longer term should a protracted Argentine-UK encounter cause the country to abandon fiscal restraint. There are already indications that the interest spread may rise from last year's average 0.75 percent over LIBOR to as high as 2 percent for new loans. [REDACTED]

³ This section and succeeding sections assume that the EC trade ban, currently approved for only 30 days, will be renewed. [REDACTED]

~~Confidential~~

~~Confidential~~

Table 2

Million US \$

Argentina:
Current Account Balance

	1981 ^a	1982 ^b
Trade balance	-70	3,000
Exports	9,130	10,300
Imports	9,200	7,300
Net services and transfers	-3,835	-4,000
Net interest	-2,600	-2,800
Current account balance	-3,905	-1,000
Amortizations	-3,480	-2,650
Financial gap	-7,385	-3,650

^a Revised estimate.

^b Projected before Falkland crisis.

^c Includes interest on short-term debt.

[REDACTED]
[REDACTED] Following an economic derailment, a severe cutback in international lending would intensify difficulties in reinstituting reform measures.

International Financial
Impact

Allowing maneuvering by the British and nervous rumblings from the weaker banks in loan syndicates, there is still little immediate likelihood that bankers will declare Argentina in default. Indeed, Buenos Aires will probably be able to avoid default so long as large banks are able to control any inclination of smaller institutions in syndicates to act rashly, and so long as Argentina is perceived as trying to meet its obligations. International banks have accommodated Poland and seem no less likely to do the same for Argentina, a country with far greater debt repayment capacity.

[REDACTED]
[REDACTED] US banks here and abroad hold one-third of Argentina's \$24 billion total bank debt, mainly short term.

Export shortfalls could imperil Buenos Aires's ability to meet debt payments over the course of 1982. Over the past two years Argentina has allocated 40 to 50 percent of its export earnings for debt servicing. If the EC trade embargo is extended, it could affect this year about 15 percent of the \$10 billion in export earnings that had been projected for Argentina,

~~Confidential~~

~~Confidential~~

Table 3

Percent

Argentina:
Structure of External Bank Debt *

Total	100
Short-term	51
1-2 years	9
More than 2 years	37
Unallocated	3

* Based on June 1981 data.

This table is Confidential.

Table 4

Million US \$

Argentina: Servicing Payments
on Medium- and Long-Term Debt, 1982 *

Total	4,780
Principal repayments	2,635
Interest payments	2,145

* IMF estimates.

[REDACTED]

The duration of the conflict and the intensity of British measures will be important factors in determining how much disruption occurs to Argentina's foreign financing.

Buenos Aires can probably afford to continue debt servicing over the next three to five months. Should the crisis persist this long, however, the domestic economy would have borne serious financial and material stresses and the need for a later generalized rescheduling would have risen appreciably.

[REDACTED]

~~Confidential~~

3 6 0 0

~~Confidential~~



~~Confidential~~

6



3 6 0 1

